What's Going On In ...

European Union/Germany

The Taxation of Artists and Sportsmen after the *Arnoud Gerritse* Decision

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INTRODUCTION

The European Court of Justice (ECJ) reached its decision in the *Arnoud Gerritse* case (C-234/01) on 12 June 2003. It answered preliminary questions from the Tax Court (*Finanzgericht*) Berlin about the taxation of a Dutch jazz drummer, who performed for a few days in Germany in 1996. This decision has major consequences for the taxation of international artists and sportsmen, not only in Germany but also in other European countries. It would appear that existing tax systems will have to be adjusted.

TAXATION IN THE COUNTRY OF PERFORMANCE

Most countries follow the OECD recommendation to tax the performance income of non-resident artists and sportsmen.[1] Article 17 of the OECD Model Convention (OECD Model) sets aside the normal allocation rules of Art. 7 (Business profits) and Art. 15 (Income from employment). The OECD gave two reasons for the special treatment of international artists and sportsmen: (1) top stars try to avoid normal taxation by pretending to live in tax havens (tax avoidance), and (2) many do not report their foreign performance income in their home country (non-compliance).[2]

With Art. 17(2) of the OECD Model, the taxation right for the source country has been extended to all payments for a performance, not only those made to the artist or sportsman but also to other entities.[3] But with the addition of Art. 17(3), some treaties transfer the taxation right to the country of residence for subsidized performances or performances based on cultural exchange or a cultural agreement.[4]

Most countries have taken over the OECD's recommendation to not allow deductions for expenses to non-resident artists and sportsmen, but to levy tax on the gross performance fee.[5] Only a few countries have implemented the accompanying low withholding tax rate, but over the years have increased the rate considerably.[6] Also, most countries do not allow non-resident artists and sportsmen to file a normal income tax return after the tax year and exclude them from the application of the normal income tax rates. The result of the high withholding tax in the country of performance is that the foreign tax credit in the home country is very often insufficient, because most countries limit the tax credit to the income tax due over the foreign income in that country.[7]

Two European countries, the United Kingdom and the Netherlands, are exceptions to this general practice. In the United Kingdom and in the Netherlands, non-resident artists and sportsmen may already deduct their expenses at the withholding stage (after approval by the tax administration) and the withholding tax is only levied on the real income of the artist or sportsman. The Netherlands levies withholding tax at a flat rate of 20%; the United Kingdom applies the progressive income tax rates, ranging from 10% to 40%.

After the tax year a normal income tax return may be filed to deduct any remaining expenses and make use of the normal income tax rates. In the United Kingdom this tax return is obligatory, but in the Netherlands the filing of an income tax return is optional and non-resident artists and sportsmen can decide to accept the 20% withholding tax as their final tax. Although a tax refund in the Netherlands is very likely because of the low income tax rates in the first bracket, very few non-resident artists and sportsmen file a return because the 20% Dutch tax can normally be sufficiently credited against the income tax in their home countries.

THE *GERRITSE* DECISION

The facts

In 1996 Arnoud Gerritse, a freelance Dutch jazz drummer, performed for a radio station in Berlin for a few days. His performance fee was EUR 3,000 gross, on which 25% tax (EUR 750) was levied. He was not allowed to deduct his expenses of EUR 500 for travel and accommodation and he was not permitted to file a normal German income tax return (*Einkommensteuererklärung*) at the end of the year. Gerritse believed he was not treated equally with other foreigners and with German residents because he was paying more tax than under the normal income tax scheme, especially when the free taxable amount (*Grundfreibetrag*) was considered.

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1. Exceptions within Europe are Ireland and Denmark.
2. Paras. 6 and 7 of the OECD Report, "Taxation of Entertainers, Artistes and Sportsmen", *Issues in International Taxation* No. 2 (Paris: OECD, 1987).
3. For a discussion of the scope of Art. 17(2) of the OECD Model, see Dick Molenaar and Harald Grams, "Rent-A-Star – The Purpose of Article 17(2) of the OECD Model", 56 *Bulletin for International Fiscal Documentation* 10 (2002), pp. 500-509.
4. This exception is based on Para. 14 of the Commentary on Art. 17 of the OECD Model.
5. See Para. 10 of the Commentary on Art. 17 of the OECD Model.
6. A low withholding tax rate would be 5% or 10%, but, in reality, the rates are: France 15%, Belgium 18%, Austria 20%, Germany 21.1% (per 2003) and Spain 25%.
7. This "ordinary tax credit" is recommended in Art. 23B of the OECD Model.

Gerritse was also not happy about his tax situation in 1996 because he received insufficient foreign tax credit in the Netherlands. The tax credit was only EUR 196, mainly because of the deduction of his business expenses, his personal allowances, the low first bracket rates of the Netherlands income tax and the loss of a part of his free taxable amount (*belastingvrije voet*).

The ECJ ruling

Arnoud Gerritse's case was brought before the Tax Court (*Finanzgericht*) Berlin. That Court considered that a breach of the fundamental freedoms of the EC Treaty was possible. It requested a preliminary ruling from the ECJ.[8] The ECJ reached its decision on 12 June 2003 and followed to a large extent the Opinion of Advocate General Léger.[9] The ECJ held:

> 1. Article 59 of the EC Treaty (now, after amendment, Article 49 EC) and Article 60 of the EC Treaty (now Article 50 EC) preclude a national provision such as that at issue in the main proceedings which, as a general rule, takes into account gross income when taxing non-residents, without deducting business expenses, whereas residents are taxed on their net income, after deduction of those expenses.
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> 2. However, those articles of the Treaty do not preclude that same provision in so far as, as a general rule, it subjects the income of non-residents to a definitive tax at the uniform rate of 25%, deducted at source, whilst the income of residents is taxed according to a progressive table including a tax-free allowance, provided that the rate of 25% is not higher than that which would actually be applied to the person concerned, in accordance with the progressive table, in respect of net income increased by an amount corresponding to the tax-free allowance.

In line with its earlier decisions, the ECJ reserved the free taxable amount to the country of residence.[10] But, in addition, the ECJ held that non-resident artists and sportsmen in Germany are entitled to deduct their expenses before tax is calculated and that a normal tax return (*Einkommensteuererklärung*) must be possible when a tax refund seems likely. It looks as though, with its ruling, the ECJ has chosen to adopt the current tax system for non-resident artists and sportsmen of a neighbouring country, the Netherlands.

The Tax Court Berlin and perhaps even the German Federal Tax Court (*Bundesfinanzhof*) will still need to take over the ECJ ruling.[11] Nevertheless, it appears inevitable that Germany will have to change its tax rules for non-resident artists and sportsmen quite drastically.

PRODUCTION EXPENSES AND THE TAXATION OF SPORTSMEN/ARTISTS

Performances or matches in other countries lead to expenses: not so much for Arnoud Gerritse, who only deducted his costs for travel and accommodation; most other artists (and sportsmen), however, incur considerable costs for their foreign appearances. These costs can be categorized as follows:

(1) travel and accommodation: buses, trucks, sometimes air travel, hotels, food and drink for a group of persons;
(2) equipment: sound, light, stage set-up, instruments, clothing and in bigger venues even video and laser equipment;
(3) accompanying persons: sound and light technicians, roadies, tour managers, tour accountants, drivers and security;
(4) agents and managers, who plan the performances and fit them in the career development of the performer or sportsman; and
(5) various: administration, legal advice, insurance, rehearsals and pre-production costs.

The conclusion that these expenses are normally quite high can be drawn from the authors' study among 150 non-resident artists and groups that performed in the Netherlands in the period January-August 2001. Compared with their performance fees, their expenses were 76% on (weighted) average. The variations were considerable, but the conclusion that more than 90% of the artists had expenses of more than 50% is justified. The population in the study was a mixed group of minor, middling and major artists. It was interesting that even the big names had between 60% and 80% expenses.[12]

At the moment the authors are extending the study to the period 2001-2003 and have included figures from more than 800 artists and groups. The figures from this larger study seem to confirm the preliminary results of the earlier study.

Performing in other countries is quite expensive. Most artists (and sportsmen) are running a serious business, with earnings and expenses. In its decision the ECJ, following the Advocate General's Opinion, clearly recognizes the importance of expenses.[13] In any case, it is reasonable that the expenses of non-resident artists and sportsmen are taken into account before the tax is calculated.

CONSEQUENCES OF THE *ARNOUD GERRITSE* DECISION

After the ECJ's decision in *Gerritse*, it no longer seems possible for countries to exclude non-resident artists and sportsmen from the deduction of expenses and from a nor-

8. Finanzgericht Berlin, 28 May 2001, *Internationales Steuerrecht* 14/2001, pp. 443-446.
9. Opinion of 13 March 2003. Unfortunately, there is no English translation available.
10. The discussion that may arise following the *F.W.L. de Groot* decision (C-385/00) is interesting, because the free taxable allowance will partly be lost when an ordinary tax credit exceeds the average tax rate in the country of residence.
11. The ECJ decision is a shock for Germany, because the Federal Tax Court had decided in another case on 25 November 2002 (I R 69/02, BFH/NV 2003, 398) that the German artist tax system was not in conflict with the EC Treaty.
12. The results of this study were published in Dick Molenaar, "Obstacles for International Performing Artists", 42 *European Taxation* 4 (2002), pp. 149-154, and Dick Molenaar and Harald Grams, "The *Arnoud Gerritse* Case of the European Court of Justice", 31 *Intertax* 5 (2003), pp. 198-204.
13. See Paras. 25-29 of the decision of 12 June 2003 (C-234/01) and the answer on the first preliminary question.

mal income tax settlement. Equal treatment also applies to these groups of taxpayers. The present and new EU Member States need to adjust their tax legislation as soon as possible to comply with the EC Treaty. This will remove a major hindrance in the cultural sector.[14] But the OECD will also have to seriously reconsider its recommendation in Para. 10 of the Commentary on Art. 17 of the OECD Model. The more nuanced artist and sportsman tax rules of the United Kingdom and the Netherlands can be used as best practice examples.

There is clearly no place for a special treatment of non-resident artists and sportsmen in the ECJ's case law, because equal treatment within an EU Member State has to apply to both residents and non-residents, to the extent they are in a comparable situation. And, according to the ECJ, artists and sportsmen are no different from other taxpayers. This conclusion can open an interesting discussion about their special position in the OECD Model. Are the reasons for a special Art. 17, mentioned above, still legitimate for EU residents?

The authors do not believe so. Firstly, the risk of tax avoidance by EU residents is low since all Member States have a normal income taxation and because the tax havens are located outside the European Union. Secondly, the non-disclosure of the foreign earnings in the home country can no longer be an argument, considering the existing bilateral treaties on the exchange of information (including artist and sportsman income) and especially Council Directive 77/799/EEC, which requires automatic and spontaneous exchange of information.

If the rationale for a special treatment of non-resident artists and sportsmen is no longer valid in the European Union, the application of Art. 17 of the OECD Model to EU citizens performing in other EU countries may seriously be questioned, especially because a multilateral treaty such as the EC Treaty prevails over bilateral tax treaties. This is an additional argument in the discussion whether Art. 17 of the OECD Model is still necessary.[15]

CONCLUSION

The *Arnoud Gerritse* decision is more important than would seem when taking a first glance at a simple case of an unknown Dutch jazz drummer performing in Berlin. The consequences of the decision for the taxation of non-resident artists and sportsmen can be enormous.

The allocation of the taxation right to the country of performance seemed to be justified and most countries use their authority to levy a withholding tax on the income of artists and sportsmen. But the ECJ has decided in the *Arnoud Gerritse* case that the deduction of expenses must be made possible and that after the tax year a credit against the normal income tax rates must be possible. A study shows that the production expenses of international performing artists and sportsmen are very often quite considerable. The ECJ decision means that not only Germany but also other (old and new) EU Member States will have to adjust their tax legislation. The legislation of the United Kingdom and the Netherlands already meets the requirements.

The decision may also have consequences for the OECD, which may have to revise its Commentary on Art. 17. Beyond that, the need for equal treatment with other EU citizens could lead to the discussion whether Art. 17 of the OECD Model may be in conflict with the fundamental freedoms of the EC Treaty.

14. See Paragraph III "Taxation" of the Report "Study on the Mobility and Free Movement of People in the Cultural Sector" by the University of Paris, commissioned by the DG EAC of the European Commission (April 2002).

15. See Harald Grams, "Artist Taxation: Art. 17 of the OECD Model Treaty – a relic of Primeval Tax Times?", 27 *Intertax* (1999), pp. 188-193; Joel Nitikman, "Article 17 of the OECD Model Treaty – An Anachronism?", 29 *Intertax* (2001), pp. 268-274; and Dick Molenaar and Harald Grams, "Rent-A-Star – The Purpose of Article 17(2) of the OECD Model", 56 *Bulletin for International Fiscal Documentation* 10 (2002), pp. 500-509.